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# Bad Faith Insurance Litigation in Pennsylvania: Recurring Issues Under Section 8371

Tina M. Oberdorf\*

## INTRODUCTION

Five years after the Pennsylvania General Assembly created for insureds a statutory remedy for the bad faith conduct of their insurers,<sup>1</sup> by enacting Section 8371 of title 42 ("Section 8371"),<sup>2</sup> the meaning and scope of this section have still not been clearly defined. Section 8371 permits courts to award interest, punitive damages and attorney's fees against insurers who have acted in "bad faith."<sup>3</sup> The problems that courts and practitioners have encountered with the statute are mainly due to the legislature's failure to provide a statutory definition of "bad faith" and its failure to provide the standards a court should apply when determining what damages should be awarded. As a result, courts and practitioners have been forced to deal with a host of complex issues when litigating bad faith cases. This article identifies and discusses those issues which commonly arise in the course

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1. This cause of action has also been referred to as a "first-party" bad faith case. As one writer has indicated:

A "first party" bad faith case is where the bad faith cause of action is based on the insurer's handling of a claim to policy benefits directly to an insured, as opposed to a "third party" case, which is based on the insurer's wrongful handling of a third party's claim against the insured under a liability policy. Joseph Decker, *Insurer Liability Under Pennsylvania's Bad Faith Statute*, PA. B. ASS'N Q., April, 1994, at 45.

2. 42 PA. CONS. STAT. § 8371 (Supp. 1994).

3. 42 PA. CONS. STAT. § 8371.

of first-party bad faith litigation, and analyzes the different methods that Pennsylvania state and federal courts have utilized in resolving these recurring issues.

#### THE NEED FOR LEGISLATIVE ACTION AND EARLY CHALLENGES

##### *D'Ambrosio v. Pennsylvania National Mutual Casualty Insurance Co.*

Historically,<sup>4</sup> Section 8371, also known as Pennsylvania's bad faith statute, was enacted as a delayed legislative response to the Pennsylvania Supreme Court's decision in *D'Ambrosio v. Pennsylvania National Mutual Casualty Insurance Co.*<sup>5</sup> In *D'Ambrosio*, the plaintiff sought to recover damages for his insurance company's alleged wrongful refusal to pay a property damage claim.<sup>6</sup> In addition to compensatory damages for the property damage claim, the plaintiff sought punitive damages and damages for emotional distress for the insurer's alleged bad faith conduct in denying the claim.<sup>7</sup> Addressing the issue of punitive damages and emotional distress, the court held that the Pennsylvania Unfair Insurance Practices Act<sup>8</sup> served adequately to deter bad faith conduct on the part of insurers.<sup>9</sup> The court rejected the plaintiff's claims for punitive and emotional distress damages based on its finding that it was not appropriate to supplement the system of sanctions already provided for in the Unfair Insurance Practices Act with a judicially created cause of action.<sup>10</sup>

Because the Pennsylvania Supreme Court in *D'Ambrosio* refused to recognize the bad faith tort cause of action already adopted by numerous other jurisdictions,<sup>11</sup> the Pennsylvania

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4. For an excellent historical analysis of bad faith tort litigation, see Decker, cited at note 1.

5. 431 A.2d 966 (Pa. 1981).

6. *D'Ambrosio*, 431 A.2d at 967.

7. *Id.* at 970.

8. PA. STAT. ANN. tit. 40, §§ 1171.1 to 1171.15 (1992).

9. *D'Ambrosio*, 431 A.2d at 970. A provision of the Unfair Insurance Practices Act permits courts to impose civil penalties for violations of the Act. PA. STAT. ANN. tit. 40, § 1171.11.

10. *D'Ambrosio*, 431 A.2d at 970-71.

11. See *D'Ambrosio*, 431 A.2d at 973 n.2 (Larsen, J., dissenting) (citing cases in which courts have adopted the bad faith tort cause of action).

Subsequent to the Pennsylvania Supreme Court's decision in *D'Ambrosio*, other courts, applying Pennsylvania law, held that Pennsylvania did not recognize a claim for bad faith against an insurer. See *Giovannitti v. Nationwide Ins. Co.*, 690 F. Supp. 1439 (W.D. Pa. 1988); *Belmont v. Guarantee Nat'l Ins. Co.*, 644 F. Supp. 850 (E.D. Pa. 1986); *Olkowski v. The Prudential Ins. Co. of America*, 584 F. Supp. 1140 (E.D. Pa. 1984); *Frank v. Lincoln Nat'l Life Ins. Co.*, 555 F. Supp. 808 (E.D.

legislature created a statutory cause of action for bad faith conduct on the part of insurers on February 7, 1990.<sup>12</sup> This statute provides:

§ 8371. Actions on insurance policies

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

- (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
- (2) Award punitive damages against the insurer.
- (3) Assess court costs and attorney fees against the insurer.<sup>13</sup>

### *Constitutional Challenges*

Initially, insurers attempted to challenge the validity of the bad faith statute on constitutional grounds. For example, insurers argued that Section 8371 violated due process because it failed to provide standards by which a court could impose punitive damages,<sup>14</sup> and that the statute was unconstitutionally vague.<sup>15</sup> In a somewhat more creative argument, insurers have also contended that Section 8371 violated equal protection because it punished insurers but not any other type of entity.<sup>16</sup>

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Pa. 1983); *Kramer v. State Farm & Casualty Ins. Co.*, 603 A.2d 192 (Pa. Super. Ct. 1992); *Baker v. Pennsylvania Nat'l Mut. Cas. Ins.*, 536 A.2d 1357 (Pa. Super. Ct. 1987); *Rodgers v. Nationwide Mut. Ins. Co.*, 496 A.2d 811 (Pa. Super. Ct. 1985); *McClaine v. Allstate Ins. Co.*, 463 A.2d 1131 (Pa. Super. Ct. 1983).

12. Act of February 7, 1990, No. 6, § 3, 1990 Pa. Laws 15, 15-16 (effective July 1, 1990).

13. 42 PA. CONS. STAT. § 8371 (Supp. 1994).

14. See *Empire Fire and Marine Ins. Co. v. Nationwide Mut. Ins. Co.*, No. 93-0325, 1993 WL 220621 (E.D. Pa. June 15, 1993); *Coyne v. Allstate Ins. Co.*, 771 F. Supp. 673, 679 (E.D. Pa. 1991). In addressing this argument, the courts found that Section 8371's punitive damage provision did not violate due process because an award of punitive damages, which is meant to punish and deter outrageous conduct, was governed by well-established Pennsylvania law following Section 908(2) of the Restatement (Second) of Torts, which provides policies, guidelines, and constraints (including appellate review) sufficient to satisfy the requirements of due process. See *Coyne*, 771 F. Supp. at 679-80; *W.W. Management & Dev. Co. v. Scottsdale Ins. Co.*, 769 F. Supp. 178, 180-81 (E.D. Pa. 1991).

15. See *Empire Fire*, 1993 WL 220621, at \*1; *Coyne*, 771 F. Supp. at 676; *Scottsdale*, 769 F. Supp. at 179-80. The courts rejected the vagueness argument and concluded that the term "bad faith" had acquired a "peculiar and universally acknowledged meaning" in the insurance industry and therefore there was no uncertainty about the conduct prohibited by the statute. *Coyne*, 771 F. Supp. at 677-78.

16. See *Polselli v. Nationwide Mut. Fire Ins. Co.*, No. 91-1365, 1993 WL 479050, at \*8 (E.D. Pa. November 12, 1993). In *Polselli*, the insurer also argued that the court should apply a strict scrutiny analysis because a fundamental property right of the insurer was at stake. *Polselli*, 1993 WL 137426, at \*8. The court reject-

These constitutional challenges were quickly disposed of by the courts;<sup>17</sup> however, these challenges brought to light several important issues.

### RECURRING ISSUES

#### *What is "Bad Faith"?*

One problem that has persistently arisen in litigation under Section 8371 is determining the type of conduct that the statute proscribes. In the absence of any statutory guidance within Section 8371 itself, courts have relied upon the "peculiar and universally acknowledged meaning" that the term "bad faith" has acquired in the insurance context.<sup>18</sup> In fashioning a definition, courts have stated that:

"Bad faith" on [the] part of [an] insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith.<sup>19</sup>

Additionally, "a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."<sup>20</sup> Although reckless conduct on the part of an insurer may constitute bad faith, mere negligence on the

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ed both this argument and the equal protection argument, and decided that a property right was not a fundamental right which would invoke a strict scrutiny analysis, nor was an insurer a suspect or quasi-suspect group. *Id.* In applying a rational basis analysis, the court asserted that, "[d]eterring insurers from acting in bad faith toward those who purchase their insurance policies is a legitimate state interest and the passage of the bad faith statute is a rational means to achieve this goal." *Id.*

17. See *Coyne*, 771 F. Supp. at 677-80 (rejecting due process and vagueness challenges); *PolSELLI*, 1993 WL 137426, at \*8 (rejecting an equal protection argument).

18. See *PolSELLI v. Nationwide Ins. Co.*, 23 F.3d 747, 751 (3d Cir. 1994).

19. *PolSELLI*, 23 F.3d at 751 (citing BLACK'S LAW DICTIONARY 139 (6th ed. 1990)); see also *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228, 1232 (Pa. Super. Ct. 1994).

20. *American Franklin Life Ins. Co. v. Galati*, 776 F. Supp. 1054, 1064 (E.D. Pa. 1991) (citing *D'Ambrosio*, 431 A.2d at 971 and *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368, 376 (Wis. 1978)).

The requirement that a plaintiff show knowledge on the part of a defendant brings to light the importance of conducting thorough discovery in a bad faith case. For an excellent article on various discovery techniques in bad faith litigation, see Richard D. Williams, *Bad Faith Litigation and Insurer vs. Insurer Disputes 1988*, in BAD FAITH LITIGATION: EMERGING TRENDS IN 1988 AND BEYOND (PLI Comm. L. & Practice Course Handbook Series No. A4-4224, 1988).

part of an insurer in its actions toward the insured cannot give rise to a finding of bad faith under Section 8371.<sup>21</sup> Conduct on the part of insurers that has been held to constitute bad faith under Section 8371 includes refusal to allow the stacking<sup>22</sup> of underinsured motorist coverage on five automobiles owned by the insureds,<sup>23</sup> refusal to pay the proceeds of a life insurance policy,<sup>24</sup> and failure to handle properly and make timely payments on a fire insurance policy.<sup>25</sup> Section 8371 has also been found to afford potential relief for conduct such as the insurer's refusal to participate in settlement negotiations in a dispute over underinsured motorist benefits,<sup>26</sup> the insurer's delay in paying insurance benefits under a Personal Catastrophe Policy,<sup>27</sup> and the insurer's failure to negotiate insurance contracts in good faith by charging excessive premiums.<sup>28</sup>

More often than not, however, courts have found the insurer's alleged conduct did not give rise to a finding of bad faith. For example, in *Kauffman v. Aetna Casualty and Surety Co.*,<sup>29</sup> the insurer brought an action seeking a declaration that it was not required to stack underinsured motorist benefits on the plaintiffs' insurance policy under Pennsylvania law.<sup>30</sup> In ruling on the declaratory judgment action, the court concluded that stacking was required.<sup>31</sup> The insurer subsequently appealed the stacking issue to the Third Circuit Court of Appeals and moved to stay

21. *Polselli*, 23 F.3d at 751.

22. As one court explained:

Stacking is where a claimant adds all available policies together to create a greater pool in order to satisfy his actual damages. It permits the total amount of uninsured motorist coverage provided for all vehicles listed in an insurance policy to be applied to the damages resulting from an accident involving only one of the vehicles.

*Terletsky v. Prudential Property and Casualty Ins. Co.*, 649 A.2d 680, 682-83 n.4 (Pa. Super. Ct. 1994).

23. See *Smokowicz v. Motorist Mut. Ins. Co.*, No. 93-1452 (W.D. Pa. filed September 1, 1993).

24. See *Butler v. Massachusetts Indem. & Life Ins. Co.*, No. 92-1571 (W.D. Pa. filed July 6, 1992).

25. See *Polselli v. Nationwide Mut. Fire Ins. Co.*, Nos. 91-1365 & 92-382, 1992 WL 247271 (E.D. Pa. September 23, 1992), *rev'd*, 23 F.3d 747 (3d Cir. 1994).

26. See *Empire Fire*, 1993 WL 220621, at \*1 (on motion to dismiss for failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6), the Court found that plaintiff alleged sufficient facts to sustain a cause of action under Section 8371).

27. See *Thomson v. Prudential Property and Casualty Ins. Co.*, No. 91-4073, 1992 WL 38132 (E.D. Pa. February 20, 1992).

28. *Alexson Supply, Inc., v. Tongue, Brooks & Co.*, No. 93-3450, 1994 WL 161377 (E.D. Pa. April 29, 1994).

29. 794 F. Supp. 137 (E.D. Pa. 1992).

30. *Kauffman*, 794 F. Supp. at 139.

31. *Id.*

arbitration pending the appeal.<sup>32</sup> The stay was denied and the arbitration panel entered judgment in favor of the plaintiffs.<sup>33</sup> The insurer refused to pay the arbitration award, moved to vacate it, and further contested the plaintiffs' petition to confirm the award in state court.<sup>34</sup>

The plaintiffs then filed suit under Section 8371 in federal district court alleging that the insurer's conduct in failing to pay the arbitration award, appealing the award, and contesting the award in state court even after the initial determination that stacking was required, all constituted bad faith.<sup>35</sup> The district court entered summary judgment in favor of the insurer finding that a reasonable fact-finder could not conclude that the insurer had acted in bad faith.<sup>36</sup>

Courts have also refused to find bad faith where the insurer made low settlement offers and disputed an arbitration award<sup>37</sup> and where the insurer refused to pay the proceeds of a fire insurance policy while disputing the plaintiff's interest in the property and participation in crimes relating to the fire.<sup>38</sup> One court has also held that an insurer acted reasonably when it reduced the insured's disability income based on alleged misstatements by the insured on his application for benefits.<sup>39</sup> The bad faith claim was dismissed on a motion for judgment on the pleadings.<sup>40</sup>

Significantly, a plaintiff in a Section 8371 case faces a heightened standard of proof with respect to the allegation of bad faith. Bad faith conduct on the part of an insurer must be proven by clear and convincing evidence.<sup>41</sup> This heightened standard of proof, together with the lack of legislative guidance as to the

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32. *Id.*

33. *Id.*

34. *Id.*

35. *Kauffman*, 794 F. Supp. at 140.

36. *Id.* at 141. The court noted that the insurer was entitled to appeal and further, if the insurer "had permitted the arbitration award to become final by paying the amount of the award, it is open to question whether Aetna could have recovered the excess amount had the Third Circuit ultimately decided the stacking issue in Aetna's favor." *Id.*

37. See *Terletsky*, 649 A.2d at 688-89 (reversing trial court's finding of bad faith, stating that the evidence demonstrated that the insurer's actions were "reasonably based").

38. See *Alberici v. Safeguard Ins. Co.*, No. 78-10515 (C.P. Delaware Cty. June 14, 1994).

39. See *American Franklin Life Ins. Co. v. Galati*, 776 F. Supp. 1054 (E.D. Pa. 1991).

40. *Galati*, 776 F. Supp. at 1065. The court concluded that "the pleadings demonstrate a reasonable basis for every action taken." *Id.* at 1064.

41. See *Polselli*, 23 F.3d at 750 (citing *Cowden v. Aetna Casualty & Surety Co.*, 134 A.2d 223, 229 (Pa. 1957)).

scope of bad faith, may account for the failure of the majority of courts to conclude that the insurer acted in bad faith.

### *Punitive Damages*

Section 8371 provides for the imposition of punitive damages if bad faith is found.<sup>42</sup> This raises the issue of what standard a fact-finder should apply in assessing whether an award of punitive damages is appropriate. The plaintiff in *Alberici v. Safeguard Ins. Co.*<sup>43</sup> argued that the standard for imposing punitive damages under Section 8371 should be a lower standard than that set forth in the Restatement of Torts.<sup>44</sup> In *Alberici*, the plaintiff asserted, *inter alia*, a cause of action under Section 8371 against her insurer for bad faith processing of a fire insurance policy claim.<sup>45</sup> The plaintiff alleged that the insurer failed to promptly take her deposition and failed to offer a reasonable settlement while the insurer disputed plaintiff's insurable interest and investigated possible criminal conduct which caused the fire.<sup>46</sup> Although the court found that the insurer had not acted in bad faith toward the plaintiff, it nevertheless addressed plaintiff's argument that the standard for imposing punitive damages under Section 8371 was different than that set forth in the Restatement of Torts.<sup>47</sup>

Relying on the punitive damage standard set forth in *Feld v. Merriam*,<sup>48</sup> the court indicated that the standard to utilize in determining whether punitive damages were warranted in a bad faith case was the same standard as that set forth in the Restatement of Torts.<sup>49</sup> The court asserted that a plaintiff seeking an award of punitive damages in a bad faith case therefore had to prove, by a preponderance of the evidence,<sup>50</sup> that the insurer's

42. 42 PA. CONS. STAT. § 8371(2) (Supp. 1994). The award of punitive damages is permissible, not mandatory. *Id.*

43. No. 78-10515 (Pa. C.P., Delaware Cty. June 14, 1994).

44. *Alberici*, slip op. at 11. Section 908(2) of the Restatement (Second) of Torts provides that:

Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant's act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.

RESTATEMENT (SECOND) OF TORTS § 908(2) (1979).

45. *Alberici*, slip op. at 9.

46. *Id.* at 10.

47. *Id.* at 11.

48. 485 A.2d 742 (Pa. 1984).

49. *Alberici*, slip op. at 11 (citing *Feld*, 485 A.2d at 747).

50. *Martin v. Johns-Manville Corp.*, 494 A.2d 1088, 1098 (Pa. 1985); *see also*



conduct was malicious, wanton, reckless, willful or oppressive.<sup>51</sup> Importantly, the court in *Alberici* noted that due to the differing standards that were involved in finding bad faith and awarding punitive damages, "not all conduct which may suggest 'bad faith' on the part of an insurer necessarily warrants the imposition of punitive damages."<sup>52</sup>

### *Who Decides Whether the Insurer Has Acted in Bad Faith?*

Although Section 8371 explicitly states that "if the court finds that the insurer has acted in bad faith toward the insured,"<sup>53</sup> some courts have permitted the jury to decide the issue of bad faith.<sup>54</sup> The seminal case addressing the issue of whether a plaintiff asserting a cause of action under Section 8371 is entitled to a trial by jury is *Thomson v. Prudential Property and Casualty Co.*<sup>55</sup> In *Thomson*, the plaintiff argued that the Seventh Amendment to the United States Constitution,<sup>56</sup> mandated that her bad faith claim be presented to a jury, despite the contrary language of the statute.<sup>57</sup> The court concluded that under the first prong of the two-part test set forth in *Cox v. Keystone Carbon Co.*,<sup>58</sup> the plain language of the statute clearly demonstrated

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*Polselli*, 23 F.3d at 750.

51. *Alberici*, slip op. at 12 (citing *Chambers v. Montgomery*, 192 A.2d 355 (Pa. 1963)).

52. *Alberici*, slip op. at 11. See also *Terletsky*, 649 A.2d at 690 (raising but not addressing the issue of whether the trial court erred in refusing to award punitive damages after finding that insurer had acted in bad faith); accord *Younis Bros. & Co., v. CIGNA Worldwide Ins. Co.*, 1994 WL 645807, at \*1 (E.D. Pa. November 16, 1994) (jury found insurance company acted in bad faith but that conduct was not outrageous and no punitive damages should be awarded).

53. 42 PA. CONS. STAT. § 8371 (Supp. 1994) (emphasis added).

54. See *Smokowicz v. Motorist Mut. Ins. Co.*, No. 93-1452 (W.D. Pa. September 1, 1993); *MacFarland v. United States Fidelity Guarantee Co.*, 818 F. Supp. 108, 112 (E.D. Pa. 1993); but cf. *Gilderman v. State Farm Ins. Co.*, No. 91-6353, 1991 U.S. Dist. LEXIS 18481, at \*4 n.2 (E.D. Pa. Dec. 18, 1991); *Coyne v. Allstate Ins. Co.*, 771 F. Supp. 673, 676 n.8 (E.D. Pa. 1991) (stating that the trial judge, not the jury, determines the issue of bad faith under Section 8371); *Carson v. I.T.T. Hartford Ins. Group*, No. 91-3113, 1991 U.S. Dist. LEXIS 10451, at \*9 n.7 (E.D. Pa. July 24, 1991).

55. No. 91-4073, 1992 WL 210088 (E.D. Pa. Aug. 24, 1992).

56. The Seventh Amendment provides:

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

U.S. CONST. amend. VII.

57. *Thomson*, 1992 WL 210088, at \*3.

58. 861 F.2d 390, 393 (3d Cir. 1988), cert. denied, 498 U.S. 811 (1990). In *Cox*, the court held that when determining whether a statutory cause of action created a right to a trial by jury, a court had to first look to the legislative intent to deter-

that the legislature intended that a court, and not a jury, decide an action under Section 8371.<sup>59</sup>

Turning to the second prong of the *Cox* test, the *Thomson* court noted that historically, the constitutional entitlement to a trial by jury depended on whether the subject matter or remedy involved was legal or equitable in nature.<sup>60</sup> The court found that because the plaintiff was requesting legal relief in the form of damages, the Seventh Amendment mandated that a jury hear the plaintiff's Section 8371 claims.<sup>61</sup>

### *What are Attorney's Fees and Costs?*

Section 8371 provides that a court may assess costs and attorney fees against the insurer.<sup>62</sup> The statute does not, however, provide an explanation of what those attorney's fees and costs may be, nor does it provide a standard for the imposition of such fees and costs.<sup>63</sup> Are the attorney's fees and costs assessed for the bad faith action or for the underlying action between the insurer and the insured for the recovery of benefits? Some courts have found that the attorney's fees and costs should be assessed for the bad faith litigation and are properly presented by petition to the court after the conclusion of the bad faith case.<sup>64</sup> Other courts, however, have not only submitted the issue to the jury,

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mine whether a trial by jury was intended, and secondly, a court had to determine whether the Seventh Amendment mandated that a jury hear the statutory cause of action. *Cox*, 861 F.2d at 393. In setting forth this test, the court in *Cox* noted that a court had to first look to the legislative history to determine whether a trial by jury was intended, because "[i]t is a cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the [constitutional] question may be avoided." *Id.* at 393 n.5 (quoting *Lorillard v. Pons*, 434 U.S. 575, 577 (1978) (quoting *United States v. Thirty-seven Photographs*, 402 U.S. 363, 369 (1971))).

59. *Thomson*, 1992 WL 210088, at \*3.

60. *Id.*

61. *Id.* at \*4. *But compare* *Younis Bros. & Co. v. CIGNA Worldwide Ins. Co.*, 1994 WL 645807 at \*4-7, (E.D. Pa. November 16, 1994) (finding that the Seventh Amendment mandated that bad faith and punitive damages issues be decided by the jury, but that issues regarding interest and attorney's fees were equitable in nature and therefore should be decided by the court).

62. 42 PA. CONS. STAT. § 8371(3) (Supp. 1994).

63. *See* *Oldham v. State Farm Ins. Co.*, No. 94-1311 (W.D. Pa. filed August 5, 1994) (insurer argued that the section of the statute which allows a court to award interest is unconstitutional because it permits the award of pre-judgment interest without an assessment of fault for the delay). *But see* *Younis Bros.*, 1994 WL 645807, \*4 (concluding that the requirement that a court find bad faith prior to awarding attorney's fees, costs and interest, provided a sufficient standard to withstand a due process challenge).

64. *See* *Polselli v. Nationwide Mutual Fire Ins. Co.*, No. 91-1365, 1993 WL 479050 (E.D. Pa. Nov. 12, 1993).

but have allowed recovery for the costs and attorney's fees that the plaintiff incurred in attempting to recover proceeds of the insurance policy in the underlying contractual dispute, but not for the bad faith litigation itself.<sup>65</sup> For example, a federal district court allowed the jury to award interest on the amount of the underlying claim that was being disputed.<sup>66</sup>

### *Retroactivity*<sup>67</sup>

Many cases have addressed the problem of whether Section 8371 can be retroactively applied.<sup>68</sup> The initial challenges to the retroactivity of the statute were made by insurers who argued that Section 8371 could not be applied to a contract of insurance entered into before July 1, 1990, the effective date of the statute.<sup>69</sup> The insurers argued that Section 8371 effectuated a substantive change that would materially alter the relationship between the insurer and the insured and therefore any application of Section 8371 to a contract of insurance entered into before July 1, 1990 should be forbidden.<sup>70</sup> Most of the courts that have addressed this argument, however, have generally found that "[S]ection 8371 may be applied to any insurance contract regard-

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65. See *Smokowicz*, transcript at 288 (finding that the plaintiffs had incurred \$150,000 in costs and attorney's fees including fees for expert opinions incurred in attempting to prove that the plaintiff's five insurance policies could be stacked). Cf. *Brandt v. Superior Ct.*, 693 P.2d 796, 800 (Cal. 1985) (holding that because the attorney's fees were an element of damages, they were to be determined by the trier of fact). The court in *Brandt* further held that in a first-party bad faith claim, an insured could recover attorney's fees incurred in recovering benefits due under an insurance policy as an element of damage proximately caused by the bad faith, but that the insured could not recover the attorney's fees that were attributable to the bad faith action itself. *Brandt*, 693 P.2d at 798.

66. See *Smokowicz*, transcript at 235, 258-59. The amount of the underlying claim was \$500,000. *Id.* The interest was awarded from the time the plaintiffs first made their demand for the benefits until the time that the benefits were paid. *Id.* The interest was apportioned as follows: interest on loss of use of \$500,000 for one and one half years and interest on loss of use of \$300,000 for twenty-one months. *Id.* The interest was apportioned in this manner because \$200,000 was paid by the insurance company one and one-half years after the initial request for the \$500,000 was made by plaintiffs. *Id.* The final \$300,000 payment was made after the arbitration panel concluded that all five insurance policies could be stacked. *Id.*

67. A Pennsylvania statute provides that "[n]o statute shall be construed to be retroactive unless clearly and manifestly so intended by the General Assembly." 1 PA. CONS. STAT. § 1926 (Supp. 1994).

68. See, e.g., *Mendel v. Home Ins. Co.*, 806 F. Supp. 1206, 1217 (E.D. Pa. 1992).

69. See *Colantuno v. Aetna Ins. Co.*, 980 F.2d 908, 910 (3d Cir. 1992); *American Franklin Life Ins. Co. v. Galati*, 776 F. Supp. 1054, 1063 (E.D. Pa. 1991); *Okkerse v. Prudential Property & Casualty Ins. Co.*, 625 A.2d 663, 665 (Pa. Super. Ct. 1993).

70. *Okkerse*, 625 A.2d at 665.

less of date,"<sup>71</sup> because the insurer's obligations under policies issued prior to July 1, 1990, were not changed by Section 8371.<sup>72</sup> The courts have reasoned that Section 8371 did not change the terms of the insurance contract, nor did it alter the rights of the parties that vested under the contract<sup>73</sup> because insurers had a duty to act in good faith toward their insureds prior to the enactment of the bad faith statute.<sup>74</sup>

Courts have focused on the time of the alleged bad faith, and not on the contract date.<sup>75</sup> As long as the bad faith conduct occurred after the effective date of the statute, courts have generally held that a bad faith cause of action could be asserted regardless of when the insurance contract was entered into.<sup>76</sup>

An exception to this general rule occurs when the bad faith allegation is that the insurer improperly denied benefits before the effective date of the statute.<sup>77</sup> A subsequent re-affirmance by the insurer to deny benefits, after the effective date of the statute, is insufficient to give rise to an actionable post-enactment bad faith allegation.<sup>78</sup> As one court has stated, the "post-enabling date activity must be separate acts of bad faith, not a continuation of a previous denial."<sup>79</sup>

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71. See *Colantuno*, 980 F.2d at 910.

72. *Okkerse*, 625 A.2d at 665.

73. *Id.*

74. *Galati*, 776 F. Supp. at 1063.

75. As one court noted, "[t]he relevant inquiry [in determining whether the statute is being retroactively applied] . . . is not the contract date, but rather when [the insurer] is alleged to have committed the bad faith conduct." *Colantuno*, 980 F.2d at 910 (citing *Coyne v. Allstate Ins. Co.*, 771 F. Supp. 673, 675 (E.D. Pa. 1991)).

76. See *Galati*, 776 F. Supp. at 1063; *Okkerse*, 625 A.2d at 666; see also *Boyce v. Nationwide Mut. Ins. Co.*, 842 F. Supp. 822 (E.D. Pa. 1994); *Coyne v. Allstate Ins. Co.*, 771 F. Supp. 673 (E.D. Pa. 1991); *Seeger by Seeger v. Allstate Ins. Co.*, 776 F. Supp. 986 (M.D. Pa. 1991); *Boland v. Nationwide Mut. Ins. Co.*, 9 Pa. D. & C.4th 27 (C.P. Blair Cty. 1991). But see *Bryant v. Liberty Mut. Ins. Co.*, No. 90-5637, 1990 WL 223126, at \*5 (E.D. Pa. Dec. 20, 1990) (concluding that applying Section 8371 to a contract formed before July 1, 1990, would alter contractual relations existing between the parties).

77. See generally *Williams v. State Farm Mut. Auto. Ins. Co.*, 763 F. Supp. 121, 127 (E.D. Pa. 1991).

78. See *Rottmund v. Continental Assurance Co.*, 813 F. Supp. 1104 (E.D. Pa. 1992); *Barbaro v. Old Line Life Ins. Co.*, 785 F. Supp. 70, 71 (E.D. Pa. 1992) (dismissing plaintiff's cause of action under Section 8371 for failure to allege bad faith conduct which occurred after the effective date of the statute).

79. *Rottmund*, 813 F. Supp. at 1106.

*Who is an Insured?*

While it may appear that the statute is clear in providing a remedy for an "insured" for the bad faith conduct of the insurer, questions have been raised, regarding who qualifies as the insured. For example, if an insurance company refuses to pay the proceeds of a life insurance policy and the named beneficiary files suit alleging bad faith on the part of the insurer, the insurer may argue that the named beneficiary is not the "insured" party who is protected by the statute.<sup>80</sup> In addressing the contention that only a named insured may assert a cause of action under Section 8371, courts have generally found that Section 8371 does not apply exclusively to the specifically named insured party; rather, "the text of the statute only requires that the alleged wrong was directed at the insured."<sup>81</sup> Therefore, in an action for failure to pay the proceeds of a life insurance policy,<sup>82</sup> a beneficiary should be able to assert a cause of action under Section 8371.<sup>83</sup> The refusal of the insurer to pay the proceeds certainly is directed toward the insured in that the insured bargained for and paid the premiums so that proceeds from the policy would be paid at the time of his or her death. Failure to pay such proceeds contra-

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80. See, e.g., *Rottmund*, 813 F. Supp. at 1108.

81. *Thatcher v. Hartford Ins. Co.*, No. 92-2093, 1992 WL 210591, at \*3 (E.D. Pa. Aug. 25, 1992); see also *Empire Fire & Marine Ins. Co. v. Nationwide Mut. Ins. Co.*, No. 93-0325, 1993 WL 220621 (E.D. Pa. June 15, 1993).

82. Cf. *Strutz v. State Farm Mut. Ins. Co.*, 609 A.2d 569 (Pa. Super. Ct. 1992). Plaintiffs filed suit against insurer and its insured to recover for injuries sustained in an automobile accident. *Strutz*, 609 A.2d at 570. Plaintiffs asserted a cause of action against the insurer under Section 8371 arguing that they were the third-party beneficiaries of the insurance contract between the defendant insured and her insurer. *Id.* at 570-71. The court rejected the third-party beneficiary theory and found that a third-party claimant could not assert a Section 8371 cause of action against an insurer because, "the insurer assumes a fiduciary position toward the insured and becomes liable to act in good faith and with due care in representing the interests of the insured." *Id.* at 571. Because the alleged bad faith conduct was not directed toward the insured, the court found that the trial court properly dismissed the Section 8371 claim. *Id.* See also *Fran & John's Doylestown Auto Center, Inc. v. Allstate Ins. Co.*, 638 A.2d 1023, 1026 (Pa. Super. Ct. 1994) (rejecting appellant's third party beneficiary argument). The court in *Fran & John's* also stated:

[I]t would be inappropriate to confer the status of third-party beneficiary upon appellant because the contract of insurance between appellee and its insured does not reflect this to be the intention of the parties. Appellee owes no contractual or legal duty of performance to appellant, as the contract of insurance is for the benefit and protection of the insureds only.

*Fran & John's*, 638 A.2d at 1026.

83. See *Horowitz v. Federal Kempler Life Assurance Co.*, 861 F. Supp. 1252, 1262 (E.D. Pa. 1994) (applying Section 8371 in case involving refusal to pay life insurance proceeds, but finding no bad faith).

venes the wishes and express directions of the insured.

Additionally, it should be noted that the assignment of the right to recovery of insurance proceeds by the insured to a third party does not prevent the assignee from asserting a cause of action under Section 8371.<sup>84</sup> Bad faith claims alone have also been found to be assignable.<sup>85</sup> If, however, the contract of insurance provides that the insurer must consent to any assignment and the insured fails to obtain the required consent, the assignment of the bad faith claim may not be recognized.<sup>86</sup>

### *Who is an Insurer?*

Under the Unfair Insurance Practices Act (the "UIPA"), an insurance agent, as well as the insurance carrier, may be liable for unfair trade practices.<sup>87</sup> Section 8371 does not indicate, however, whether an insurance agent is an insurer who may be liable for a bad faith claim. In the absence of any statutory definition of "insurer," courts and practitioners must glean from other statutes and similar cases the scope of the term "insurer." In *T & N PLC v. Pennsylvania Insurance Guaranty Association*,<sup>88</sup> the court addressed the issue of whether the Pennsylvania Insurance Guaranty Association was an insurer within the meaning of Section 8371.<sup>89</sup> The court turned to other Pennsylvania statutes pertaining to insurance — the UIPA and the Insurance Guaranty Association Act<sup>90</sup> — and found that the Pennsylvania Insurance Guaranty Association was not an insurer that could be sued under Section 8371.<sup>91</sup>

Although the court in *American Franklin Life Insurance Co. v. Galati*,<sup>92</sup> did not directly address the issue of whether a cause of

84. See *Thatcher*, 1992 WL 210591, at \*3.

85. See *Empire*, 1993 WL 220621, at \*2.

86. See *High-Tech Enterprises v. General Accident Ins. Co.*, 635 A.2d 639 (Pa. Super. Ct. 1993); see also *Fran & John's Auto Center*, 638 A.2d at 1023.

87. PA. STAT. ANN. tit. 40, § 1171.3 (1992) (defining "person" as "any individual . . . including agents, brokers and adjusters").

88. 800 F. Supp. 1259 (E.D. Pa. 1992).

89. *T & N PLC*, 800 F. Supp. at 1261.

90. PA. STAT. ANN. tit. 40, §§ 1701.101 - 1701.605 (1992 & Supp. 1994).

91. *T & N PLC*, 800 F. Supp. at 1262. The court noted that:

[The Pennsylvania Insurance Guaranty Association] is not in the "business" of insurance within the meaning of the Pennsylvania Unfair Insurance Practices Act, or otherwise. PIGA issues no policies, collects no premiums, makes no profits, and assumes no contractual obligations to the insureds. Its "business" is confined to providing insureds with a limited form of protection from financial loss occasioned by the insolvency of their insurer.

*Id.* at 1263.

92. 776 F. Supp. 1054 (E.D. Pa. 1991).

action under Section 8371 could be asserted against the insurance agent who was a third-party defendant in the case, the court intimated that if the insured "has an action against American Franklin and [the insurance agent] for bad faith . . . it may only arise out of actions taken by American Franklin and [the insurance agent] on or after the effective date of Section 8371."<sup>93</sup> The court found, however, that the insured had failed to allege any conduct on the part of the insurance agent that occurred on or after July 1, 1990, and therefore dismissed any claims against the agent on that basis, without addressing whether the agent could be liable under the statute.<sup>94</sup>

It does not seem appropriate, however, to allow an insurance agent to be named as a defendant in an action pursuant to Section 8371. According to the universally acknowledged meaning of insurer within the industry, an insurer is:

[An] underwriter or insurance company with whom a contract of insurance is made. The one who assumes risk or underwrites a policy, or the underwriter or company with whom [the] contract of insurance is made.<sup>95</sup>

Furthermore, the Pennsylvania Insurance Guaranty Association Act provides that an insurer is, "any insurance company, association or exchange which is authorized to write and is engaged in writing within this Commonwealth, on a direct basis, property and casualty insurance policies."<sup>96</sup> Clearly, under these definitions an insurance agent would not qualify as an insurer and thus could not be sued under Section 8371. Although the UIPA defines "persons" to include insurance agents and adjusters, Section 8371 does not include persons who act in bad faith toward the insured, but instead applies only to "insurers." The UIPA definition of "person" is therefore not applicable in determining who is an "insurer" for purposes of Section 8371.

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93. *Galati*, 776 F. Supp. at 1063.

94. *Id.* Indeed, it does not appear that this argument was even raised by the parties.

95. *T & N PLC*, 800 F. Supp. at 1262 (quoting BLACK'S LAW DICTIONARY 139 (6th ed. 1990)).

96. PA. STAT. ANN. tit. 40, § 1701.103 (1992).

### *The Role of the UIPA in Bad Faith Litigation*

The UIPA sets forth an extensive regulatory scheme which defines unfair methods of competition and unfair or deceptive practices of persons in the insurance industry.<sup>97</sup> Courts have addressed whether these regulations may be used to determine whether an insurer has acted in bad faith pursuant to Section 8371. In *Romano v. Nationwide Mutual Fire Insurance Co.*,<sup>98</sup> the Pennsylvania Superior Court indicated that a trial court may consider "the alleged conduct constituting violations of the UIPA or the regulations in determining whether an insurer . . . acted in bad faith."<sup>99</sup> Importantly, while the UIPA may provide *guidance* in determining what constitutes bad faith, an insurer's violation of the UIPA should *not* be construed as *per se* bad faith.<sup>100</sup>

### *Emotional Distress Damages*

In *Duffy v. Nationwide Mutual Insurance Co.*,<sup>101</sup> the plaintiff sought to recover, *inter alia*, emotional distress damages under Section 8371 after the defendant insurer refused to pay more than \$500 of plaintiff's restitution for a driving under the influence criminal violation.<sup>102</sup> The defendant insurer was allegedly obligated to pay the restitution under plaintiff's insurance policy.<sup>103</sup> As a result of the defendant insurer's refusal to pay the restitution, the plaintiff was discharged from the Accelerated Rehabilitation Disposition Program and the charges against her were reinstated.<sup>104</sup> The insurer, after subsequently affirming that the restitution would be paid under the policy, confessed judgment against the plaintiff insured.<sup>105</sup> The insurer did not pay the balance of the restitution it was obligated to pay under the policy until the plaintiff moved to open the judgment.<sup>106</sup> On a motion to dismiss the complaint for failure to state a claim

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97. PA. STAT. ANN. tit. 40, § 1171.5 (1992).

98. 646 A.2d 1228 (Pa. Super. Ct. 1994).

99. *Romano*, 646 A.2d at 1233. *Accord* *MacFarland v. United States Fidelity & Guarantee Co.*, 818 F. Supp. 108 (E.D. Pa. 1993); *Rottmund v. Continental Assurance Co.*, 813 F. Supp. 1104 (E.D. Pa. 1992); *Coyne v. Allstate Ins. Co.*, 771 F. Supp. 673 (E.D. Pa. 1991).

100. *See Romano*, 646 A.2d at 1232 (holding that the UIPA did not provide a private cause of action).

101. No. 93-1474, 1993 WL 475501 (E.D. Pa. Nov. 10, 1993).

102. *Duffy*, 1993 WL 475501, at \*1.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*



upon which relief could be granted, the court found that under the terms of Section 8371, there could be no recovery for emotional distress damages.<sup>107</sup> The court reasoned that Section 8371 was enacted as:

[A] direct response to the Pennsylvania Supreme Court's decision in *D'Ambrosio*, in which the court declined to judicially impose punitive and emotional distress damages for an insurer's bad faith contractual breach, expressly leaving that to the legislature . . . . The legislature answered the call, but only partially: it limited recovery to punitives, interest, court costs, and attorneys fees. The act was silent as to damages for emotional distress. *Expressio unius est exclusio alterius* . . . the legislature did not intend to provide for emotional distress damages.<sup>108</sup>

To date, no court has allowed emotional distress damages.

### *Bad Faith Conduct During the Course of Litigation*

An issue of particular importance under Section 8371 is whether alleged bad faith conduct on the part of the insurer *during the course of litigation* can give rise to a cause of action under that section. Although three United States District Court decisions have indicated that an insurer can be liable under Section 8371 for bad faith conduct during the course of litigation,<sup>109</sup> there appears to be some confusion over what "conduct during the course of litigation" actually means.

In *Rottmund v. Continental Assurance Co.*,<sup>110</sup> the court found that the insurer's "intentional misdesignation of a corporate deponent" and "concealment of the absence of new facts and circumstances which would justify the defendant's denial of its own prior allegations regarding the identity of the murderer of [the insured]" during the course of litigation could potentially give rise to a finding of bad faith under Section 8371.<sup>111</sup> In reaching its decision to deny defendant's motion *in limine* to preclude the plaintiff from presenting any claim for damages under Section 8371, the court relied upon *Kauffman v. Aetna Casualty & Surety Co.*<sup>112</sup> Concluding that *Kauffman* permitted recovery for bad

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107. *Duffy*, 1993 WL 475501, at \*4.

108. *Id.* (citing *D'Ambrosio v. Pennsylvania Nat'l Mutual Casualty Ins. Co.*, 431 A.2d 966, 970 (Pa. 1981)).

109. See *Albertini Restaurants, Inc. v. Nationwide Mutual Ins. Co.*, No. 93-1669, 1993 WL 209583 (E.D. Pa. June 10, 1993); *Rottmund*, 813 F. Supp. at 1104; *Kauffman v. Aetna Casualty & Surety Co.*, 794 F. Supp. 137 (E.D. Pa. 1992).

110. 813 F. Supp. 1104 (E.D. Pa. 1992).

111. *Rottmund*, 813 F. Supp. at 1109.

112. *Rottmund*, 813 F. Supp. at 1109-10 (citing *Kauffman v. Aetna Casualty & Surety Co.*, 794 F. Supp. 137 (E.D. Pa. 1992)). In *Kauffman*, the court noted, "this

faith misconduct during litigation, the *Rottmund* court determined that the alleged acts of the insurer could constitute bad faith under Section 8371.<sup>113</sup>

The *Rottmund* court's reliance on the decision in *Kauffman* is misplaced. Although the court in *Kauffman* noted that the conduct at issue "occurred during the pendency of litigation,"<sup>114</sup> that court was addressing the issue of whether Section 8371 provided an independent cause of action or whether a plaintiff had to assert a cause of action in the underlying contractual dispute between the parties.<sup>115</sup> More importantly, however, that court was addressing different allegations of bad faith than those at issue in *Rottmund*. In *Kauffman*, the allegations concerned the insurer's obligations to the insured under an insurance policy.<sup>116</sup> The insurer's actions at issue in *Rottmund*, such as misdesignating a corporate deponent, did not concern the insurer's obligations under the insurance policy.

Furthermore, sanctions for such conduct are more appropriately addressed through the rules of civil procedure. In fact, the defendant in *Rottmund* raised the argument that the exclusive remedy for any alleged misdesignation of a corporate deponent was "sanctions for harassment, unnecessary delay, or needless increase in the cost of litigation in the course of discovery," under the Federal Rules of Civil Procedure.<sup>117</sup> However, the *Rottmund* court found that no authority had been cited by the parties that indicated that the Federal Rules of Civil Procedure provided an exclusive remedy.<sup>118</sup> The court further found that there was no "indication that [the Federal Rules] preempt State law that attempts to address a very specific problem: bad faith conduct of

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case presents an unusual situation in that plaintiffs allege bad faith, *not in the pre-litigation handling of their claim, but in conduct that occurred during the pendency of litigation*, at a stage when Aetna's declaratory judgment action was before the Third Circuit." *Kauffman*, 794 F. Supp. at 140 (emphasis added).

113. *Rottmund*, 813 F. Supp. at 1110.

114. *Kauffman*, 794 F. Supp. at 140.

115. *Id.*

116. *Id.* In *Kauffman*, the allegations of bad faith on the part of the insurer were:

(1) [the insurer's] insistence on proceeding to arbitration, rather than tendering the \$1 million limit under the policy, after [the] court's decision of January 4, 1991, on the stacking issue; (2) [the insurer's] opposition to plaintiffs' motion to confirm the arbitration award in state court; and (3) [the insurer's] refusal to pay the remaining amount of the arbitration award until the Third Circuit rendered its decision on the stacking issue [on appeal].

*Id.*

117. *Rottmund*, 813 F. Supp. at 1110 (citing FED. R. CIV. P. 26(g), 37(a)(2)).

118. *Rottmund*, 813 F. Supp. at 1110 (citing *Hanna v. Plumer*, 380 U.S. 460 (1965)).

insurers, even where that bad faith conduct occurs in the context of litigation.<sup>119</sup>

Although the Federal Rules of Civil Procedure may not be the exclusive remedy, holding insurers liable for conduct such as misdesignating a corporate deponent does not comport with the purpose of Section 8371. The goal of Section 8371 is to ensure that the special fiduciary relationship between insurers and their insured is not abused, and to require that insurers uphold their duty of good faith and fair dealing.<sup>120</sup>

The fiduciary obligation of the insurer arises in the relationship with the insured with respect to the contract of insurance. The insurer is not, simply by virtue of being a litigant in a civil action, assuming a special fiduciary position. Thus, holding the insurer liable under Section 8371 for bad faith that has nothing to do with the special fiduciary relationship is unfair, unnecessary, and has no statutory foundation. The conduct that Section 8371 seeks to deter involves only the relationship between the insured and the insurer. Bad faith actions should be confined to allegations which arise as a result of this relationship.

This proposition does not exclude bad faith conduct on the part of the insurer simply because it occurs during the pendency of an action; rather, it simply precludes allegations of bad faith that are unrelated to the insurer/insured relationship.<sup>121</sup> For example, an insurer's frivolous initiation of a declaratory judgment action — i.e., where the insurer unreasonably and without sufficient basis disputed its obligation to pay proceeds under an insurance policy — could give rise to a cause of action for bad faith. However, if an insurer defendant improperly removed a cause of action under an insurance policy from state court to federal court — i.e., the action was improper because the amount in controversy was insufficient for federal court — the insured would not have a Section 8371 cause of action because the insurer's action did not violate the fiduciary relationship.

The proposition that Section 8371 is aimed at deterring conduct involving only the insured/insurer relationship is further supported by the text of Section 8355 which was enacted the same day as Section 8371.<sup>122</sup> Section 8355 provides sanctions

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119. *Rottmund*, 813 F. Supp. at 1110.

120. See, e.g., *Romano*, 646 A.2d at 1231. The court noted that "[t]he insurer's duty of good faith . . . is contractual and arises because the insurance company assumes a fiduciary status by virtue of the policy's provisions which give the insurer the right to handle claims and control settlement." *Id.*

121. 42 PA. CONS. STAT. § 8371 (Supp. 1994).

122. See 42 PA. CONS. STAT. § 8355. Under Rule 1451 of the Pennsylvania Rules of Civil Procedure, the Pennsylvania Supreme Court has suspended, in part,

punishing an attorney for, *inter alia*, filing pleadings, motions, or other papers in bad faith.<sup>123</sup> The sanctions include assessment of costs, reasonable attorney fees, and possibly a civil penalty not to exceed \$10,000.<sup>124</sup> Clearly, if the legislature intended to include the bad faith conduct of attorneys during the course of litigation as conduct punishable under Section 8371, there would have been no need to enact section 8355. As the court in *Boland v. Nationwide Mutual Insurance Co.*,<sup>125</sup> stated, "the terms of Section 8371 as a companion provision to section 8355 in Act 6 may not be extended to the conduct of attorneys."<sup>126</sup>

### *Does Section 8371 Provide an Independent Cause of Action?*

Many courts have determined that Section 8371 is not merely an additional remedy for a plaintiff in a contractual dispute with an insurance company.<sup>127</sup> This has very important implications. First, this allows an insured to commence suit under Section 8371 even if the underlying claim for benefits has been resolved.<sup>128</sup> In other words, a plaintiff may commence a separate and independent suit solely under Section 8371.<sup>129</sup> Secondly, an insurer may move to sever the bad faith claim from the underlying contract claim and have them tried separately.<sup>130</sup>

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the operation of Section 8355. See PA. R. CIV. P. 1451.

123. 42 PA. CONS. STAT. § 8355.

124. *Id.*

125. 9 Pa. D. & C.4th 27 (C.P. Blair Cty. 1991).

126. *Boland*, 9 Pa. D. & C.4th at 37 n.4.

127. See *Kauffman*, 794 F. Supp. at 140; *Romano*, 646 A.2d at 1231; *March v. Paradise Mut. Ins. Co.*, 646 A.2d 1254, 1256 (Pa. Super. Ct. 1994).

128. See, e.g., *March*, 646 A.2d at 1256.

129. *But cf.* *Winterberg v. CNA Ins. Co.*, 868 F. Supp. 713 (E.D. Pa. 1994) The court, while recognizing that Section 8371 created a separate and independent cause of action, found that a claim under Section 8371 had to be "related to at least one other colorable claim over which the court has jurisdiction." *Winterberg*, 868 F. Supp. at 722. This result not only ignores the clear import of the term "separate and independent cause of action," but it also provides an opportunity for insurers to avoid liability for bad faith conduct. For example, if an insurer initiates a declaratory judgment action in order to dispute its obligation to pay the proceeds of an insurance policy without reasonable basis and in bad faith, and the declaratory judgment action is subsequently settled, the insured should still be able to file suit, in the forum of the insured's choice, against the insurer for bad faith under Section 8371. See, e.g., *Albertini Restaurants, Inc. v. Nationwide Mut. Ins. Co.*, No. 93-1669, 1993 WL 209583 (E.D. Pa. 1993).

130. See *MacFarland v. United States Fidelity & Guarantee Co.*, 818 F. Supp. 108, 112 (E.D. Pa. 1993); *Thomson v. Prudential Property & Casualty Ins. Co.*, No. 91-4073, 1992 WL 210088, at \*4 (E.D. Pa. Aug. 24, 1992).

### *Preemption*

Several United States District Court decisions have addressed the issue of whether Section 8371 is preempted by the Employee Retirement Income Security Act ("ERISA")<sup>131</sup> when the insurance contract is part of an employee benefit plan.<sup>132</sup> The courts have found that Section 8371 is preempted by ERISA because it does not fall within the category of state laws which are exempted from ERISA's savings clause.<sup>133</sup> Therefore, where the underlying policy is part of an employee benefit plan that is covered by ERISA, the insured may not bring an action for bad faith based on Section 8371.

### *Motor Vehicle Financial Responsibility Law*

An insurer's alleged bad faith conduct regarding the medical necessity<sup>134</sup> of first-party medical benefits claims cannot be the subject of a cause of action under Section 8371 because Section 1797 of the Motor Vehicle Financial Responsibility Law,<sup>135</sup> provides the exclusive remedy for the review and payment of first-party insurance claims.<sup>136</sup> The rationale that courts have used

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131. Employee Retirement Income Security Act of 1974, as amended by the Multiemployer Pension Plan Amendments Act of 1980, 29 U.S.C. §§ 1001-1461 (1986 & Supp. 1994).

132. See *Garner v. Capital Blue Cross*, 859 F. Supp. 145 (M.D. Pa. 1994); *Ruth v. Unum Life Insurance Co. of America*, No. 94-3969, 1994 WL 481246 (E.D. Pa. Sept. 6, 1994); *Rallis v. Trans World Music Corp.*, No. 93-6100, 1994 WL 96264 (E.D. Pa. March 25, 1994); *Ferry v. Mutual Life Insurance Co. of New York*, No. 93-709, 1994 WL 500964 (W.D. Pa. Feb. 14 1994); *Booz v. Unum Life Ins. Co.*, No. 93-2326, 1993 WL 313372 (E.D. Pa. July 29, 1993).

133. See, e.g., *Ruth*, 1994 WL 481246, at \*5.

134. See *Barnum v. State Farm Mut. Auto Ins. Co.*, 635 A.2d 155 (Pa. Super. Ct. 1993); see also *Seeger*, 776 F. Supp. at 990. In *Seeger*, an insurer questioned whether an insured's medical expenses were covered under its policy; the court indicated that that issue was "obviously not amenable to resolution by the procedures set forth in section 1797(b)." *Seeger*, 776 F. Supp. at 990. *Accord Knox v. Worldwide Ins. Group*, 140 Pittsburgh Leg. J. 185 (C.P. Allegheny Cty. 1992). The court in *Knox* asserted:

Whether or not the [medical] treatment was related to the automobile accident is not an issue for which § 1797(b) provides peer review evaluations . . . [therefore] § 1797(b) does not bar bad faith claims under § 8371 for a denial of coverage which is based on findings of a peer review organization on issues for which there is no provision for a peer review under § 1797(b).

*Knox*, 140 Pittsburgh Leg. J. at 189.

135. PA. STAT. ANN. tit. 40, §§ 1701.101 to 1701.605 (1982 & Supp. 1994).

136. See *Grove v. Aetna Casualty & Surety Co.*, 855 F. Supp. 113 (W.D. Pa. 1993); *Stepanuk v. State Farm Mutual Automobile Ins. Co.*, No. 92-6095, 1993 WL 489209, at \*4 (E.D. Pa. Nov. 29, 1993); *Fetterman v. State Farm Mutual Automobile Ins. Co.*, No. 93-3940, 1993 WL 460803 (E.D. Pa. Nov. 5, 1993); *Danley v. State*

in reaching this conclusion is that the general provisions of Section 8371 conflict with the specific provisions of the Motor Vehicle Financial Responsibility Law governing the conduct of insurers.<sup>137</sup> However, at least three courts have asserted that with regard to first-party wage-loss benefits, an insured may state a cause of action under Section 8371.<sup>138</sup>

### *Does Section 8371 Apply to All Types of Insurance Policies?*

Despite vigorous objections on the part of insurers, courts have generally held that Section 8371 does not apply exclusively to motor vehicle insurance policies. This argument was raised by insurers who reasoned that since Section 8371 was enacted as part of an act entitled "Motor Vehicle Insurance, Pleadings, Operators of Commercial Vehicles, etc.," the legislature must have intended that bad faith actions only be brought under motor vehicle insurance policies.<sup>139</sup> This argument has been rejected by the courts.<sup>140</sup> Many different types of insurance policies have been the subject of Section 8371 actions.<sup>141</sup>

## CONCLUSION

Even though Pennsylvania's bad faith statute is still relatively new, its adoption has spawned a great deal of litigation. This litigation has been complicated by the difficulty encountered by courts and practitioners in interpreting the provisions of Section 8371. Much of this difficulty can be attributed to the lack of legislative guidance provided in the statute itself. This article has been an attempt to identify the many issues raised by the stat-

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Farm Mutual Auto Ins. Co., 808 F. Supp. 399 (M.D. Pa. 1992); *see also* Gemini Physical Therapy and Rehabilitation, Inc. v. State Farm Mut. Auto. Ins. Co., No. 91-0013, 1993 WL 409922 (E.D. Pa. October 12, 1993), *aff'd*, 40 F.3d 63 (3d Cir. 1994).

137. *See Seeger*, 776 F. Supp. at 989; *Barnum*, 635 A.2d at 158.

138. *See Weisbein v. The Home Ins. Co.*, No. 93-6909, 1994 WL 121033 (E.D. Pa. April 11, 1994) (finding that Section 1716 penalizes insurers for different conduct than Section 8371 and therefore a plaintiff can claim punitive damages under Section 8371 for denial of a wage-loss claim under an auto insurance policy); *Danley*, 808 F. Supp. at 402; *Seeger*, 776 F. Supp. at 991. *But cf. Riddell v. State Farm Fire & Cas. Ins. Co.*, No. 91-1461, 1992 WL 209971, at \*3 (M.D. Pa. July 9, 1992) (finding irreconcilable conflict between Sections 8371 and 1716 and holding that Section 8371 could not be applied to claims for wage-loss benefits).

139. *See Boring v. Erie Ins. Group*, 641 A.2d 1189, 1192 (Pa. Super. Ct. 1994).

140. *See Boring*, 641 A.2d at 1192.

141. *Id.* at 1192-93 (citations omitted). *See also Zabrecky v. American Title Ins. Co.*, No. 93-4464, 1994 WL 416286, at \*5-6 (E.D. Pa. Aug. 8, 1994) (applying Section 8371 to an action on a title insurance policy); *Turner Construction Co. v. First Indemnity of America Ins. Co.*, 829 F. Supp. 752, 763-64 (E.D. Pa. 1993) (applying Section 8371 to an action on a surety bond).

ute, to review the recent judicial treatments and interpretations of these issues, and to offer some suggestions for future cases. Doubtless, in the absence of any additional legislative action, new issues and interpretations will continue to arise.